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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

OREGON MUTUAL LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above case on June 12, 1940, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The "Memorandum Findings of Fact and Opinion" of the Board is unpublished, but will be found at pages 43 to 49 of the record. The opinion of the Circuit Court of Appeals (R. 194) is reported in 112 F. (2d) 468.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 12, 1940 (R. 197). By order of this Court (R. 198), the time for filing a petition for a writ of certiorari was extended for a period of sixty days from September 12, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether reserves required by state laws to be maintained by a life insurance company for total and permanent disability benefits on policies of combined life, health, and accident insurance constitute "reserve funds required by law," within the meaning of Section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 8–16.

STATEMENT

From the Memorandum Findings of Fact and Opinion of the Board of Tax Appeals (R. 43–49), the following pertinent facts appear:

The taxpayer is a mutual life insurance company, organized under the laws of the State of Oregon, engaged in the business of issuing life insurance on the level premium plan, including the

granting of annuities and the issuance of disability and double indemnity insurance (R. 44).

On December 31, 1933, the taxpayer had in force 24,382 life-insurance policies of which 11,060 were "disability" policies and 13,322 were "nondisability" policies (R. 44).

On December 31, 1934, the taxpayer had in force 25,177 life-insurance policies of which 10,701 were "disability" policies and 14,476 were "non-disability" policies (R. 44).

The life-insurance policies designated "non-disability policies" provided for death benefits only (R. 44), while those policies designated "disability policies," in addition to providing death benefits, also provided that upon proof by the insured before the age of 60 of his total and permanent disability, the taxpayer would (1) waive the payment of premiums by the insured, and (2) would pay the insured annually an amount equal to one-tenth of the face of his policy during the continuance of his disability (R. 45).

The mean of the reserves maintained by the taxpayer for death benefits only on both its "disability" policies and "non-disability" policies during the respective tax years 1933 and 1934 was as follows (R. 46):

Type of policy	1933	1934
Non-disability policies	$5,643,477.25	$6,093,400.64
Disability policies	3,875,458.52	3,681,444.65

The Commissioner allowed deductions for the statutory percentage of the mean of the taxpayer's foregoing reserves for death benefits (R. 47), and the taxpayer's reserves for death benefits only are not here in issue (R. 44).

The taxpayer during the tax years 1933 and 1934 also carried additional reserves to meet its contingent liabilities under the disability provisions of its "disability" policies (R. 45). Two reserves were carried, one being shown on the company's Annual Statement (Convention Edition) [Exhibits A and B, p. 5, item 8, R. 178, 180] as "Extra reserve for total and permanent disability benefits," and the other [Exhibits A and B, p. 5, item 10, R. 179, 181] as "Present value of amounts incurred but not yet due for total and permanent disability benefits", the first for convenience being called "active life reserves" and the second being called "disabled life reserves" (R. 45). These additional reserves held by the taxpayer at the beginning and end of the respective taxable years and the mean thereof were as follows (R. 45):

	Active life	Disabled life
1933		
Jan. 1	$108,347.16	$124,875.42
Dec. 31	110,314.43	121,107.04
Mean	109,330.79	122,991.23
1934		
Jan. 1	110,314.43	121,107.04
Dec. 31	111,940.74	158,359.97
Mean	111,127.58	139,733.51

Under the level premium plan the amount of the premium charged for disability benefits is constant throughout the period that the insured is entitled to the disability benefits. During the first years that policies are outstanding the premiums received by the company are in excess of the amounts paid out under the policies. As the policyholders advance in age the situation is reversed and the current premiums and interest are no longer sufficient to meet current claims. Because of this situation the taxpayer created reserves out of current premiums and interest in each year to meet its future liabilities under the disability provisions of its policies. The amount of the reserve necessary to meet future liabilities is determined by reference to combined mortality and disability tables (R. 46).

As each "active life" becomes disabled, the taxpayer creates out of its "active life reserve" another reserve, the "disabled life reserve," to enable it to pay disability benefits to become due in the future as long as the disabled policyholder remains alive and disabled (R. 46). There is no duplication between the "active life reserve" and the "disabled life reserve" (R. 46).

The reserves maintained by the taxpayer in the taxable years complied with the requirements of the Department of Insurance of the State of Oregon (R. 47).

The Commissioner denied the taxpayer's claims for deductions of 3¾ percent of the mean of the

additional reserves set up under policies containing disability provisions, that is, (1) reserve for active lives, and (2) reserve for disabled lives (R. 47).

The Board held the taxpayer entitled to deductions based on its active and disabled life reserves carried under the disability provisions of its life insurance policies as "reserve funds required by law," within the meaning of the federal statutes, and the Circuit Court of Appeals affirmed the Board's decision.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding and deciding that the reserve entitled "Extra reserve for total and permanent disability benefits," maintained by taxpayer at the beginning and end of each of the calendar years 1933 and 1934, constituted "reserve funds required by law," within the meaning of Section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

2. In holding and deciding that the reserve entitled "Present value of amounts incurred but not yet due for total and permanent disability benefits", maintained by taxpayer at the beginning and end of each of the calendar years 1933 and 1934, constituted "reserve funds required by law," within the meaning of Section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

3. In holding and deciding that taxpayer's additional "active life" and "disabled life" reserves formed or constituted a proper basis for computing

the deductions allowed by Section 203 (a) (2) of the Revenue Acts of 1932 and 1934.

4. In affirming the decision of the Board of Tax Appeals.

REASON FOR GRANTING THE WRIT

The question involved herein is presented in *Helvering* v. *Pan-American Life Ins. Co.*, No. 264, this Term, certiorari granted, October 28, 1940. The same issue is likewise involved in *New World Life Ins. Co.* v. *United States*, No. 2, this Term, in which the Government's motion to dismiss was denied on October 14, 1940.[1] If it should be decided in those cases that the taxpayer is not entitled to the deduction in controversy, then the judgment below in this case would have to be reversed.[2]

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

NOVEMBER 1940.

[1] In the argument of the *New World* case the Government expects to renew the contention made in the motion to dismiss to the effect that the issue is moot in that case.

[2] But even if those cases should be decided against the Government on the possible narrow ground that the Commissioner was without authority to amend his regulations retroactively, such result would affect only the year 1933 in this case. As to the year 1934, the only applicable regulations (Regulations 86, Art. 203 (a) (2)–1) were in harmony with the Government's position from the very first day of their promulgation. Accordingly, even if the Government should not prevail in the *Pan-American* and *New World* cases, the present petition should be granted, and the judgment below reversed as to the year 1934.

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APPENDIX

The pertinent provisions of the Revenue Act of 1932, c. 209, 47 Stat. 169, 223–227, pertaining to the tax on life insurance companies read as follows:

SUPPLEMENT G—INSURANCE COMPANIES

SEC. 201. *Tax on Life Insurance Companies.*

(a) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

* * * * *

SEC. 202. *Gross Income of Life Insurance Companies.*

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * * *

SEC. 203. *Net Income of Life Insurance Companies.*

(a) *General Rule.*—In the case of a life insurance company the term "net income" means the gross income less—

(1) *Tax-Free Interest.*—The amount of interest received during the taxable year

which under section 22 (b) is exempt from the taxes imposed by this title;

(2) *Reserve Funds.*—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

The foregoing provisions of the Revenue Act of 1932 have been reenacted without change in Supplement G of the Revenue Act of 1934, c. 277, 48 Stat. 680, 731–735.

Treasury Regulations 77, promulgated under the provisions of the Revenue Act of 1932, on February 10, 1933, as to the deductions allowable to life insurance companies on account of reserve funds, provides in part, as follows:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

* * * * *

(2) Four percent of the mean of the reserve funds required by law and held at the

beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ percent shall be substituted for 4 percent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

* * * Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the

reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.

Article 971 of Treasury Regulations 77 was amended by Treasury Decision 4615, XIV–2 Cum. Bull. 312, approved December 18, 1935, to read, so far as material here, as follows:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

* * * * *

(2) Four percent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ percent shall be substituted for 4 percent.

In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running

expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

* * * * *

Treasury Regulations 86, promulgated under the provisions of the Revenue Act of 1934, as to the deductions allowable to life insurance companies on account of reserve funds, provides by Article 203 (a) (2)–1 in part as follows:

ART. 203 (a) (2)–1 *Reserve funds.*—In general, the reserve contemplated is a sum of

money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings

for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

* * * * *

Oregon Code Annotated, Official Edition, 1930, Vol. 3:

INSURANCE DEPARTMENT

46–117. *Definition, classification and separation of insurance.*—(1) *"Insurance Company" Defined.*—A company, association, partnership or individual engaged in the business of insurance, or suretyship, or of guaranteeing against liability, loss or damage, or of entering into contracts substantially amounting to insurance, shall be deemed an insurance company and shall not transact such business unless the business is authorized or permitted by the laws of the state of Oregon, and all laws regulating the same and applicable thereto have been complied with.

(2) *Classification and Separation.*—A company may be licensed to make any or all insurance and reinsurance comprised in any one of the following numbered subdivisions:

* * * * *

Second. *Life Insurance.*—On the lives of persons and every insurance appertaining thereto or connected therewith, including endowments, and to grant disability benefits and purchase or dispose of annuities.

* * * * *

46–122. *What Insurance May Be Effected.*—* * *

(5) *Risks Included in Life Insurance Policy.*—Insurance in one policy may be effected by any company authorized to transact such business in this state, upon the lives of persons and every insurance appertaining thereto or connected therewith, including endowments, disability benefits and annuities. * * * .

46–137. *Assets — Liabilities — Reserve.*— * * * In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, *a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits.* In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners. * * *

LIFE INSURANCE GENERALLY

46–503. *Commissioner to value policies.*— (1) *Time and Manner of Making Valuations.*—The commissioner shall annually make valuations of all outstanding policies, additions thereto, and all other life insurance and annuity obligations of every life insurance corporation doing business in this state. All valuations made by him, or his authority, shall be made upon the net premium basis.

(2) *Legal Minimum Standards for Life Insurance Policies.*—The legal minimum standard for the valuation of life insurance contracts issued before the first day of January next following the passage and approval of this act shall be the method and basis of valuation heretofore applied by the insurance department of this state in the valuation of such contracts, and for life insurance contracts issued on and after said date shall be the one year preliminary term method of valuation, on the basis of the American Experience Table of Mortality with interest at three and one-half per centum per annum.

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